SC93061

IN THE SUPREME COURT OF MISSOURI

LOREN COOK CO.,

Appellant,

vs.

DIRECTOR OF REVENUE,

Respondent.

Appeal from the Administrative Hearing Commission
The Honorable Nimrod T. Chapel, Commissioner

BRIEF OF RESPONDENT

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STATEMENT OF FACTS

The Statement of Facts of Taxpayer-Appellant Loran Cook Co. ("Cook") is largely complete. But it omits some detail and in some respects mixes the two transactions at issue: Cook's purchase of an airplane from Cessna; and Cook's sale of another airplane to C.B. Aviation. We focus on the details of those two transactions, insofar as they are contained in the record.

Purchase of the 525B.

We turn first to Cook's purchase. That process began in August 2005, when Cook entered into a purchase agreement with Cessna Aircraft Company to buy a new Citation CJ3, referred to by its model number, 525B. Administrative Record (AR) 17. The form purchase agreement stated, "A Trade-in Agreement is not part of this Purchase Agreement unless stated otherwise in the Agreement." Ex. 2[1], LCC000197. Rather than "state otherwise," the agreement made clear that there was no trade-in: by hand, the parties struck though the following paragraph, and initialed the change:

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[1] Petitioner's 3 exhibits were given numbers; Respondent's exhibits were designated with letters. Here we simply use "Ex." with the number or the letter, along with the page number showing on the exhibit, where available. The exhibits have all been filed with the Court.

> This agreement is contingent upon Purchaser obtaining a satisfactory trade-in quotation on their current aircraft, Citation CJ2, Unit 525A0118, on or before August 19, 2005. Should a satisfactory trade-in quotation not be received on or before said date, this Agreement shall become null and void and all deposits, without interest, shall be returned to Purchaser within 30 days of Seller's receipt of Purchaser's written notification that a satisfactory traded-in quotation was not obtained.

Ex. 2, LCC000201.

Not surprising, given that language in the contract form, negotiations between Cook and Cessna included discussion of a trade-in. Tr. 84. Cook thus "had the option of trading it[s] old airplane] to Cessna, and … chose not to." Tr. 85.

Cook paid Cessna a $150,000 deposit in 2005 and "a $400,000 progress payment" in 2006. AR 17. Cessna kept Cook apprised of the progress of manufacturing and equipping the 525B. Thus a Cessna customer service representative sent Cook photographs of the 525B when it was nearing completion in April and May of 2007. Tr.49:9-12, 50:22-25, 51:15-16, 54:12-22;

Ex. N, LCC000577-84; Ex. O, LCC000560-67. Some of these photographs show the tail and registration number assigned to Cook's new 525B. Tr.51:17-25, 52:1-25, 53:8-14; Ex. N, LCC000582; Ex. O, LCC000561, LCC000563-64, LCC000566-67. Cook responded to the pictures by referring to the pictured aircraft as "OUR plane." Tr.55:23-25, 56:1-10; Ex. P, LCC002260 (emphasis in original).

Consistent with the description of the plane as "ours," on September 7, 2007 Cook sent Cessna a list of items that Cook wanted to done on the 525B before Cook would accept delivery. (Tr.62:1-7 and Ex. Q, LCC001666-70). Cessna acknowledged those items—and that airplane was being prepared for sale to Cook. Tr.62:14-21; Ex. Q, LCC001668.

As the time for completion and delivery of the 525B approached, Cook decided to involve a third-party intermediary in order to qualify for federal income tax benefits relating to depreciation. Cook's witness explained:

> Loren Cook, wanted to exercise its rights to utilize what's been referred to and is referred to as a 1031 exchange, or a like-kind exchange, for the purpose of deferring its federal and its state income tax that arises as a result of the sale of an asset that they've

> been depreciating over how many years that they[] owned it.

Tr. 90. So Cook assigned the contract to purchase the 525B from Cessna to Time Value Property Exchange (TVPX).[2] Ex. 2, LCC000290. Under that agreement, TVPX was to accept delivery of the 525B and transfer it to Cook. *Id.*

The authorized, on-the-ground representative of TVPX for the transaction—the only person, it appears from the record (*see* Tr.112:6-24), who was with and saw the plane at the moment its ownership was transferred to TVPX and on to Cook—was James E. Thorne. Thorne "was chief pilot for Loren Cook at the time." AR 18. Thorne was not paid by TVPX for acting as its agent. (Tr.113:23-23).

The transfer occurred on June 26, 2007. James Thorne, for TVPX, accepted delivery of the 525B at 3:12 p.m. Ex. 2, LCC000264. At 3:13 p.m., Thorne, now also for Cook, accepted delivery for Cook. Ex. 2, LCC000252.

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[2] When the assignment was fully documented is not clear from the record. Respondent's Exhibit Q shows that at least some documents that were part of the assignment package for the 525B were completed in September 2007, months after Cook had taken title and possession of the aircraft.

The other documents relating to the actual sale do not give us that kind of precision. We do know, however, that on June 26 the Contracts of Sale of the aircraft and its engines were also registered with the International Registry of Mobile Assets (www.internationalregistry.aero/)—and at what times. According to title searches performed later, the sales contracts for the two engines of the 525B from Cessna to TVPX were registered at 4:34 p.m. Ex. 2, LCC000275, 278. By that time, the registration of the engine sales contracts from TVPX to Cook had already been registered—at 4:19 and 4:22 p.m. Ex. 2, LCC000275, 278. Logically, there was no time at which the engines and the aircraft were registered as being owned by TVPX. And there is no document nor testimony that tells us at what time the sale became effective to transfer title—other than the documents detailing delivery and acceptance.

The record contains limited information regarding the movement of money on June 26. It contains an "Escrow Deposit Form," showing Cook as "Exchangor" (and entitled to all interest) and TVPX as "Intermediary." Ex. 1, LCC000406. The form indicated that $4,723,050.00 was to be sent on June 26, 2007, to Wachovia Bank (the same bank involved in the *Great Southern Bank v. Director of Revenue*, 269 S.W.3d 22 (Mo. banc 2008)). *Id*. And the

record includes a signed disbursement instruction for the same amount, but it is not dated. Ex. 2, LCC000246.

Sale of the 525A

Before contracting for the 525B, Cook already owned a Cessna jet—a Citation CJ2, referred to by its model number, 525A. Years after entering into the agreement with Cessna to buy the 525B, Cook advertised the 525A for sale. AR17. C.B. Aviation LLC responded, contacting Loren Cook on May 13, 2007 about the purchase of the 525A. Tr.40:19-25, 41:1-5, 41:22-25, 42:1-2; Ex. I, LCC002440-42. On June 15, 2007, representatives of C.B. Aviation and Cook signed a sales agreement. Ex. 1, LCC000300-309. The agreement listed Cook as "seller" and C.B. Aviation as "buyer." *Id. see also* AR 17-18.

Cook assigned the sales contract for the 525A to TVPX. Ex. 1, LCC000351. On June 26, 2007, Cook's employee Mr. Thorne signed for and accepted delivery of the 525A on behalf of TVPX—and simultaneously signed on behalf of Cook. Ex. 1, LCC000414. That occurred at 2:26 p.m. *Id.* At 2:27 p.m., Mr. Thorne, accepted delivery of the 525A—signing on behalf of both TVPX and C.B. Aviation. Ex. 1, LCC000423.

The record contains bills of sale on FAA-approved forms for both Cook to TVPX (Ex. 1, LCC000408) and TVPX to C.B. Aviation (Ex. 1, LCC000418). Those are dated June 26; they do not indicate what time they were signed or

became effective, nor whether or when they were submitted to or approved by the FAA.[3] In terms of timing, we do know that the security agreements between C.B. Aviation and the lender on the 525A and its engines were registered at 3:37, 3:40, and 3:44 p.m.—all after Mr. Thorne accepted delivery of the 525A for C.B. Aviation. Ex. 1, LCC000438.

[3] For an example of what the owner of an airplane would receive from the FAA, see the 2003 FAA registration for Cook's 525A. Ex. 1, LCC000427.

ARGUMENT

The issue here, as in *Great Southern Bank v. Director of Revenue*, the issue in Appellant's Point II, is whether, by involving in a particular, very limited way an "intermediary" in the purchase of one airplane and the sale of another, a taxpayer can combine those two transactions to claim that the airplane sold to one person was "taken in trade" for the airplane purchased, quite independently, from someone else.

We say that is the issue that divides us because the Director agrees that the "trade-in" statute, § 144.025, applies to use tax (Appellant's Point I). The general use tax is imposed by § 144.610. That section, in turn, applies to property that would have been subject to sales tax under § 144.020. An airplane is "tangible personal property" covered by § 144.020. Section § 144.025 creates a "taken in trade" reduction for personal property covered by the sales tax, and thus for property covered by the use tax. That an airplane is not covered by the motor vehicle title provision addressed by the AHC, § 144.440 (*see* AR 20-21), is irrelevant. Were it otherwise, this Court's decision in *Great Southern Bank* would be wrong. The Court should reverse the AHC with regard to the coverage question.

We return, then, to the real issue: the combination of two transactions into one by limited use of an intermediary. This Court addressed that issue in

Great Southern Bank in circumstances that almost precisely parallel those here. Notably, Cook does not ask the Court to reject the *Great Southern Bank* holding. Instead it asks the Court to distinguish this case on its facts. But what seems to be the key fact for Cook—that Cook arranged for a single third-party to momentarily hold title in each of the two transactions—does not adequately distinguish it from the transactions in *Great Southern Bank*. Here, too, the Court should "look beyond legal fictions and academic jurisprudence in order to uncover the economic realities of the case." *Scotchman's Coin Shop, Inc. v. Admin. Hearing Comm'n,* 654 S.W.2d 873, 875 (Mo. banc 1983), quoted with approval, *Great Southern Bank*, 269 S.W.3d at 25.

Like this case, *Great Southern Bank* arose from the sale of one airplane to one person and the purchase of another airplane from another person. There, too, the sale and purchase involved a single third-party intermediary. There, too, the principal purpose of bringing the intermediary into the process was to gain a federal tax advantage. This Court described how the transactions were undertaken in *Great Southern Bank*:

> On June 18, 2003, Great Southern entered into an agreement to sell a Beechcraft airplane to Jet 1, Inc. The sale price was $1,025,000. Nine days later,

Great Southern entered into a "Purchase Agreement" to buy a 1993 Cessna airplane from Scag Engineering, LLC for $1,925,000. The Purchase Agreement included blank lines for "Trade–In Aircraft (if applicable)," including the make and model of the aircraft, trade-in delivery date, and delivery destination. None of these blanks was filled in.

In order to facilitate the transaction, Great Southern entered into an "Exchange Agreement" with Wachovia Bank, N.A. The Agreement provided that Great Southern would acquire the Cessna from Wachovia and then relinquish the Beechcraft to Wachovia. The transaction was structured to meet the requirements for an exchange of "like kind" property for purposes of Section 1031 of the United States Internal Revenue Code, which permits the deferral of certain federal taxes for property transfers that are channeled through a qualified intermediary. Jet 1 directed its payment for the Beechcraft to a title

> insurer and then to Wachovia. Great Southern then made its payment to the same title company, which then forwarded the funds to Wachovia. Wachovia then sent Great Southern's $1,925,000 payment for the Cessna to Scag Engineering. Great Southern paid use taxes on $900,000, which was the difference between the sale price of the Beechcraft ($1,025,000) and the purchase price of the Cessna ($1,925,000).

269 S.W.3d at 24. Great Southern took the position that interjecting Wachovia into both the purchase and sales transactions combined those transactions into a single one, in which one airplane was "taken in trade" for another.

This Court rejected that claim. The Court found that although Wachovia "acted as an intermediary to facilitate a transaction under Section 1031 of the United States Revenue Code, it [did] not follow that there was a 'trade' exempting Great Southern from paying Missouri use taxes." 269 S.W.3d at 25. Because

> Wachovia could not keep [either plane, but instead] … simply performed the duties assigned in its agreement with Great Southern[,] Wachovia never

> took the Beechcraft in trade for anything. Wachovia effectively was acting as Great Southern's agent for the purpose of complying with federal regulations to take advantage of the tax deferral provisions of Section 1031.

Id. at 25.

In *Great Southern Bank*, the Court demanded more than a "legal fiction." *Id.* Yet what Cook presents is a "legal fiction," albeit a slightly different and more complicated one. TVPX never actually controlled either airplane. Legally, its actions were closely constrained by the contractual agreement under which TVPX earned its $3,000. That agreement required—and allowed—TVPX to do no more than facilitate the transfer of one plane from Cessna to Cook and the other from Cook to C.B. Aviation. Physically, TVPX left control of both airplanes to Cook and Cook's employee.

Again, Cook asks this Court to focus on whether title passed through the hands of TVPX. In one sentence in *Great Southern Bank*, this Court used language that Cook may have read to suggest such focus. After quoting dictionary definitions for the terms "trade" and "exchange," the Court wrote: "A 'trade,' then, requires that the parties each have title to or ownership of their respective items and then exchange them." *Id.* at 25. But the Court did

not hold, as Cook's argument here would require, that briefly giving the intermediary title to each plane would be enough to transform the purported trade from legal fiction to meaningful reality. Title is a prerequisite for a trade, but the Court did not say in *Great Southern Bank*, nor should it hold here, that title is sufficient when the facts otherwise demonstrate that the title transfer is ephemeral.

A conclusion that title transfer is dispositive could not be reconciled with the principal authority on which the Court relied in *Great Southern Bank*, *Hutton v. Johnson*, 956 S.W.2d 484 (Tenn. 1997). Hutton used Bell Aviation, Inc., "an aircraft brokerage firm," as an intermediary. *Id.* at 486. Like TVPX, Bell Aviation acquired title to the airplane being sold. *Id.*[4] But there is no hint in *Hutton* that having the intermediary hold title could be dispositive. The fact remained that there were really two separate transactions. The Tennessee court refused to let the involvement of a single intermediary, even an intermediary who briefly held legal rights that

[4] The Tennessee court did not determine whether the title to the airplane being purchased was ever held by Bell Aviation, though there is a suggestion that the title may have gone directly from Cessna, the seller, to Hutton. *See id.* at 487.

described as "title," meld the two transactions into one in which there was a trade of one airplane for another.

Ultimately, the claim that TVPX played any greater role here than Wachovia did in *Great Southern Bank* is illusory. True, TVPX was registered with the FAA. But presumably so was Bell Aviation. And why should that matter, if the airplane itself was always under the direct control of Cook's employee, Mr. Thorne? And if Cook took delivery of the 525B and C.B. Aviation took delivery of the 525A, all via Mr. Thorne, just one minute later?

That Cook and its agents or affiliates created a paper trail does not give substance to the illusion. Indeed, the omissions from the paper trail reinforce the conclusion that the there really was no "trade" here. There is little evidence of the movement of money—except that TVPX was paid $3,000 for its services. Tr. 103. There is no evidence of FAA registration of TVPX's ownership. And the evidence regarding the timing of the transfers does not suggest that each movement to and then from TVPX was anything but simultaneous. All the documents that relate to the timing of sales are dated June 26. The documents recording the timing of the registration of the sales suggest that the registrations were simultaneous: indeed, the registrations of some sales *by* TVPX occurred *after* the registration of the sales of the same items *to* TVPX. In terms of timing, the only evidence in the record suggesting

that there was *any* period during which TVPX "owned" either airplane, in any sense, is found in the delivery documents—the ones that show Mr. Thorne accepted delivery for TVPX one minute and for the buyer the next minute.

The claim that TVPX bore the economic risk of loss during those two minutes does not give substance to the illusion. During those minutes, the airplanes were under the control of Cook's own employee. And during those minutes TVPX was legally protected from any liability, should Mr. Thorne err, by a contract under which Cook would indemnify TVPX in, among other things, the unlikely event of a natural disaster at that precise moment. *See* Tr. 108-09, Ex. 1, LLC000330-331.

The possibility that TVPX could have breached the contract and sold either airplane to someone else is belied by the fact that TVPX never had physical custody of either airplane. Mr. Thorne could have thwarted such a sale. And a hypothetical breach of contract by a company whose continued success depends on its credibility with future clients should not change the result.

Ultimately, TVPX was "contractually obligated" (Tr. 102) to do precisely what it did: to prepare and execute documentation under which title to each plane would momentarily move through TVPX, and authorize Cook's

employee to handle the actual receipt of the new plane and both the delivery of and receipt for the old one. That is not distinguishable, in meaningful way, from what Wachovia did in *Great Southern Bank*. Despite the assignments and bills of sale, what we see here are two transactions: a purchase arranged between Cessna and Cook; and a sale between Cook and C.B. Aviation. Nothing having been "taken in trade," Cook does not qualify for the statutory exception.

Hopefully, this Court's opinion will not dwell on the peculiar merits of the curious factual circumstances of this case and the one in *Great Southern Bank*. The Court should more broadly inform future purchasers of airplanes that despite the decision of the federal government to permit use of an intermediary to create a legal fiction that two independent transactions constitute a single "exchange," Missouri sales and use tax law looks to the reality of the transactions. And the reality here is that although Cessna would have "taken in trade" the 525A for the 525B, Cook declined.

CONCLUSION

For the foregoing reasons, the decision of the Administrative Hearing Commission should be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE AND COMPLIANCE

I hereby certify that a true and correct copy of the foregoing was filed and served electronically via Missouri CaseNet on June 27, 2013, to:

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I further certify that a true and correct copy of the foregoing was served via Inter-Agency mail on June 27, 2013, to:

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The undersigned further certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b) and that the brief contains 3,226 words.

/s/ *James R. Layton*
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